

UNIVERSITY OF PENNSYLVANIA

Deals:

The Economic Structure of Transactions and Contracts

LAW 720/MGMT 717

Spring 2024

Mondays and Wednesdays 3:30 to 5:00
Huntsman Hall (JMHH), room tbd

Professor Daniel M. G. Raff
SH-DH 2034
215-898-3804
raff@wharton.upenn.edu
<Email to be preferred>

Teaching assistants:
Waleed Haj Hassan (LLM 2020)
Rheem Brooks
James Trollan
Devin Tusa

This course is about the creation of value through transaction and contract design. It is to some extent also about value capture. The goals of the course are to explain how private parties structure and negotiate their commercial interactions, to discuss theories of how they ought to do so, and to give students a thorough understanding of the deal-making process.

The basic idea in the background is that both the structuring of transactions and the execution of contracts are informed by a limited number of core economic ideas. The lawyer or banker or other financial services industry professional executing a contract or structuring a transaction can be analogized to a structural engineer, someone whose job it is to choose from a range of possible transactional structures or contractual terms one that is well-suited to the particulars of the situation, that addresses potential stresses or challenges, and that overall seems likely to maximize the total distributable value. Although transactional structures and contractual provisions appear to have almost unlimited possible variation, a small number of core economic issues cause most of the problems and in practice a limited number of basic approaches to addressing them are deployed, and sometimes balanced, in the course of deciding what to do. Accordingly, the aims of this course are to familiarize students with the basic economic issues that impact transactional structures, to teach students how to recognize these issues when they

arise, to familiarize students with the generic solutions to these problems, and to learn how to match existing solutions and problems. In addition, students will learn how to fine tune these generic solutions to specific problems, and more broadly to develop the skills necessary to devise appropriate solutions to apparently new problems.

The first two months will be devoted to discussion of barriers to transacting – including information problems and strategic behavior – and a range of techniques to respond to them as well to other practical aspects of the deal process. In the final five weeks of the course, student teams will apply the tools developed in Part I to a series of recent and particularly interesting, completed transactions. This syllabus covers the first of these two parts in detail. The second part will be laid out once the semester is underway.

Required reading: Course materials on Canvas and in the syllabus plus occasional in-class handouts. For optional background reading on mergers and acquisitions for those interested, Christopher S. Harrison, *Make the Deal: Negotiating Mergers and Acquisitions* (New York: Wiley, 2016) can be had from Amazon or the publisher. (The publisher would, of course, appreciate it if you would buy it directly.)

Course deliverables: Regular attendance and active participation, Team Part II deal-related responsibilities (team’s class presentation and execution of secondary team role), and a short individual end-of-term paper related to the deal you worked on.

Course mechanics and Part II responsibilities are described in detail in a separate memo.

Please read everything on this syllabus. The cases, newspaper articles, and other materials that are the basis for extended in-class discussion are in **bold**. Please read these materials particularly carefully beforehand and come to class ready to discuss them in depth.

Regular attendance and active class participation is expected.

There will be a reception following the final class session in Part II. Students, partners, and even hungry house-mates will all be welcome.

Note well: The course is designed to be self-contained for both Law and Wharton students. Term for the Law School starts a week before term for Wharton. Classes 0 and 00 on the syllabus below will take place in that week and are therefore intended for Law students only. (Wharton students are of course welcome to peruse the material if they like and Professor Raff would be happy to discuss any questions arising with Wharton students who would like to talk any of the readings through.) Class 000, which is also for Law students only, will take place on February 28, also not a Wharton teaching day.

Syllabus:

Class 0 (January 8)

An introduction to some background ideas for the course I

NB: LAW STUDENTS ONLY

Michael S. Knoll and Daniel M.G. Raff, Real Sports Investments and the First Major League Baseball Self-IPO. (*A minor-league pitcher named Randy Newsom is selling shares of his future earnings. Should you invest?*).

Class 00 (January 10)

An introduction to some background ideas for the course II

NB: LAW STUDENTS ONLY

School's Brief: Unlocking Corporate Finance, *The Economist* 81-82 (December 8, 1990).
Michael S. Knoll, The Modigliani-Miller Theorem at 60 The Long-Overlooked Legal Applications of Finance's Foundational Theorem, 36 *Yale Journal on Regulation Bulletin* 1-7, 12-17 (2018).

(For the very curious, see also Franco Modigliani and Merton H. Miller, The Cost of Capital, Corporation Finance, and the Theory of Investment, 48 *American Economic Review* 261-97 (1958).)

Steve Lohr & Michael J. de la Merced, GE Breaks Up with Its Storied Past, NY Times, Nov. 10, 2021.

NB: NO CLASS FOR ANYONE ON JANUARY 15 (MLK DAY)

Class 1 (January 17)

Introduction to the Course and Value Creation through Transaction Design

Michael Klausner, Analysis Research and Reports on the Web (ARROW) exercise. (*A startup firm is running out of money. There are two offers on the table. Which should the founder/controlling shareholder accept?*)

[NB: More detailed study questions appear at the end of each exercise. Hereafter, just look for study questions at the end of each exercise.]

Class 2 (January 22)

Value Creation through Organization Design

Adolph Berle and Gardiner Means, The Modern Corporation and Private Property (1932) 119-125.

William A. Sahlman, The Structure and Governance of Venture-Capital Organizations, 27 Journal of Financial Economics 473, 489-493, 503-506 (1990).

Ronald J. Gilson and Daniel M.G. Raff, Visa exercise.

Class 3 (January 24)

Introduction to Mergers and Acquisitions

Albertsons-Kroger Agreement and Plan of Merger, October 13, 2022, skim Articles II and III (mainly the merger and the effect of the merger on capital stock).

Robert Bruner, Applied Mergers and Acquisitions 531-38.

William J. Carney, Essentials of Mergers and Acquisitions 13-25.

Class 4 (January 29)

Informational Asymmetry: Adverse Selection I

Michael Klausner, Real Estate Deal with Free Look Clause exercise.

Michael Klausner, Genre Productions: Pre-arranged Distribution Agreement exercise.

Class 5 (January 31)

Informational Asymmetry: Adverse Selection II

Ronald J. Gilson, Value Creation by Business Lawyers: Legal Skills and Asset Pricing, 94 Yale Law Journal 239-280 (1984). (Hereafter “Value Creation”).

James Freund, Anatomy of a Merger 242-248 (1975).

Albertsons-Kroger, Agreement and Plan of Merger skim Articles IV and V (representations and warranties of company and of parent and acquisition sub).

Grumman v. Rohr 748 F.2d. 729.

Class 6 (February 5)

Agency Costs: Moral Hazard I

Albertsons-Kroger, Agreement and Plan of Merger, skim Articles VI, VII, and VIII (covenants, closing conditions, termination).

Ward Farnsworth and Eric Posner, Agency, in Ward Farnsworth, The Legal Analyst: A Toolkit for Thinking About the Law 87-93 (2007).

Michael S. Knoll and Daniel M.G. Raff Proposed Sale of the Illinois Lottery exercise.

Michael Klausner, Genre Productions: Movie Financing exercise.

Class 7 (February 7)

Agency Costs: Moral Hazard II

Ronald J. Gilson Value Creation 280-293.

Ronald J. Gilson and Reiner H. Kraakman, Mechanisms of Market Efficiency, 70 Virginia Law Review 549, 613–621 (1984).

A note on Hotel Management and Ownership.

Waleed Y.W. Haj Hasan, Rocky: A Case Study of the Adrian Hotel exercise.

Class 8 (February 12)

An Introduction to Contracting Techniques for Dealing with Risk and Uncertainty

Frank H. Knight, Risk, Uncertainty, and Profit, pages 233-234.

Ronald J. Gilson, Microvision Corporation Acquisition of Installit, Inc.: Negotiating an Earnout exercise [A] case.

Ronald J. Gilson, Charles F. Sabel, and Robert E. Scott, “Innovation and Contract: Adaptability and Collaboration in an Uncertain World,” Draft, chapter 1.

Class 9 (February 14)

MACs, Earnouts, and Information

Robert J. Gilson and Alan Schwartz, Understanding MACs: Moral Hazard in Acquisitions, 21 Journal of Law, Economics & Organization 330, 30-40, 45-48, 55-58 (2005).

Ronald J. Gilson and Daniel M.G. Raff, Duraflame exercise.

Mark Maremont, Buffet Makes \$4.5 Billion Deal with Pritzkers, Wall Street Journal December 26, 2007.

Ronald J. Gilson and Daniel M.G. Raff, Roy Vagelos and Oskar Grunwald exercise.

Class 10 (February 19)

Asset Specificity I

Fountain Manufacturing Agreement between Apple Computer Inc., and SCI Systems, Inc. Indicative Summary of Terms for Secured Loan Facility [to the General Motors Corporation], December 19, 2008.

Michael S. Knoll, Wayne Huizenga’s Acquisition of the Miami Dolphins and Joe Robbie Stadium exercise.

Class 11 (February 21)

Asset Specificity II

Ronald J. Gilson, Victor P. Goldberg, and Robert H. Mnookin, Proton Corporation negotiation exercise (NB: Teams will be assigned and materials circulated on February 19th. The exercise should be completed between Class 10 and when we assemble for Class 11.)

Class 12 (February 26)
Tax I: Taxation of Corporate Acquisitions and Dispositions

Michael S. Knoll, HCA's Acquisition Tax Strategy exercise.

Videos to be viewed before class; they can be watched at between 1.5x and 2x.
Taxation: Basic Principles (40 minutes)
M&A Taxation Part 1 (39 minutes)
M&A Taxation Part 2 (21 minutes)

Class 000 (February 28)
An Introduction to Business Strategy
NB: LAW STUDENTS ONLY

Readings (chiefly a business school case) to be assigned

NB: NO CLASS FOR ANYONE ON MARCH 6 or 8 (UNIVERSITY SPRING VACATION)

Class 13 (March 11)
Tax II: Special Topics in Taxation (also from a certain perspective the climax of Part I)
Guest speakers: Lewis Steinberg and Adam Perry, Bank of American

Materials to be distributed

Class 14 (March 13)
Loose Ends, Reprise of Part I and a glimpse forward towards the exam,
and an Introduction to Part II

Material to be distributed

Classes 15-24 (March 18 through April 17)
The Deals

List of transactions and materials to be distributed